1938

Economic Conditions
Governmental Finance
United States Securities

New York, February, 1938

General Business Conditions

THE opening month of the new year has brought a spotty improvement in orders in some of the industries and commodity markets, but nothing like a general forward movement or revival. After four months or more of sharp curtailment in buying, many distributors have had to come back into the markets to fill in stocks, and manufacturers have moderately increased their purchases of materials. However, the improvement is limited, and the volume is encouraging only in comparison with what had gone before. The situation is bound to be full of irregularities and contradictions at this stage. In some lines and some trade channels inventories have begun to run low, while in others stocks are still excessive. Some industries have curtailed as much as necessary to balance the market position for the present, and a few are increasing their operations slightly, but others probably will have to reduce further unless their sales pick up more convincingly.

In general, the improvement in buying has not warranted an increase in industrial output. Preliminary figures indicate that composite production indexes for January will be a point or two lower than for December, when the Federal Reserve index was 84 (1923-25 = 100). This compares with 89 in November, 102 in October, 111 in September, and 117 in August. The January change, therefore, is the smallest since September, and signifies a flattening of the trend after the unprecedentedly rapid decline.

The lines in which new orders have been larger include cotton goods and other textiles and apparel, and the non-ferrous metals. The steel industry has had only slight improvement in its sales, but a moderate increase in output over the low rate at the year-end was warranted, as steel production manifestly has been below consumption for many weeks. Mill operations have expanded to 32.7 per cent of capacity.

The automobile situation is not encouraging. A representative of the Automobile Manufacturers Association testified in Washington early in the month that dealers' stocks of new cars were the largest since 1930, and used car stocks are extremely heavy. Domestic passenger car sales in December were about 45 per cent less than a year earlier, and it is questionable whether January has brought much improvement. Hence no increase in production is expected until the Spring pickup in sales arrives, and total assemblies during February will be smaller than in January, even after allowance for the shorter month. Business in many quarters is feeling the lack of orders from the automobile and parts manufacturers.

Prices Stable but Sentiment Conservative

The prevailing opinion of business men seems to be that the recession will pass through its low point during the first quarter, and possibly is already doing so; but expectations as to the rate of recovery are conservative. Since the outlook for the second quarter depends so greatly on what is done in the first quarter, the disposition is to defer prophecy. The commodity markets give a good illustration of the general sentiment. The decline in prices of staple commodities leveled off in November. Moody's index, covering 15 commodities which are traded on the exchanges, dropped from a level of 205 to 210 in July and August to 144.6 on Nov. 24, which was the low. Lately it has fluctuated a little above 150 (Dec. 1931 = 100).

This stability, lasting for two months despite extremely slow buying and general uncertainty, is encouraging, since business could hardly be expected to revive while rapidly falling prices were spreading demoralization. Although supplies in all lines are ample, they are not being pushed for sale to the extent of clogging the markets. Where plans for controlling production or shipments are in existence quotas have been cut, and both organized and unorganized holding movements and price-supporting programs, some backed by governments, are in operation.

Nevertheless, it would be incorrect to say that confidence in prices, even of the raw materials and farm products which have dropped

most sharply, has been genuinely reestablished. Obviously too much depends upon general conditions. Unless the increase in demand is substantial a good many markets will be under pressure. As inventories are reduced buying must recover to the level of current consumption; but not much in the way of forward covering is looked for in the near future.

Prices of many manufactured products, notably in textile and apparel lines, have been reduced to levels likely to inspire confidence as the general situation stabilizes. But there are some important exceptions, which are still priced at the peak. Steel is one of these. Buyers in these lines are doubly cautious. They understand that prices are unprofitable to producers at current levels of costs and operations, and that cost reduction cannot go very far as long as wage rates are inflexible; but in the general view the fact that prices are below cost does not of itself warrant the risk of commitments.

Capital Expenditures Small

Moreover, in looking ahead it is all too easy to find general reasons for uncertainty. Prospects for an increase in new investment in the industries, and resulting capital goods expenditure, have shown no material improvement since the year-end. It is true that the market for the highest-grade, riskless type of bonds has broadened, and that corporations in position to offer securities of that class can raise money advantageously, but these corporations are not generally in need of new capital. The weak market for bonds of lower rating dampens hopes for an expansion of capital investment through that channel. There has been no lessening of the uncertainties affecting the ability of the public utility companies to do financing, and the Erie receivership is a demonstration of the railroad difficulties caused by declining traffic and increased expenses.

Undoubtedly, also, current business conditions are a restraint on borrowers as well as lenders. There is fear that the resistance of prices to adjustment, due to greater rigidity of costs than ever before, will slow down recovery, and that inflexible costs will limit earnings and multiply losses. Figures thus far reported suggest that earnings of industrial corporations in the fourth quarter were around 30 per cent less than a year earlier. Even if the long-term capital markets were open, business men would be loath to go ahead with plant expenditure until they could see more assurance of profitable operation.

Evidence of the recession in capital goods spending is plentiful. Machine tool orders in December ran behind a year earlier by 45 per cent, and the drop would have been greater but for a rise in foreign orders, which constituted 63 per cent of the total, the highest proportion on record. Domestic orders alone were the smallest since March, 1935. Building contract awards during the first three weeks of January were a little larger than a year ago by reason of increased public works, but residential awards were down 50 per cent and nonresidential 49 per cent. The number of railway freight cars on order January 1st was 7,947 against 25,592 a year earlier, and of steam locomotives 131 against 297.

The Responsibility of Individuals

Evidently the chief hope of Spring improvement lies not in increased capital expenditures, but in a quick correction of the obstacles to trade. The prevailing caution and uncertainty, although unfavorable for new projects, give assurance that business men are doing precisely what they can do to clear the situation; namely, work off inventories, improve efficiency, and strive to get costs and prices down, as far as they can, to the point where goods will move. No individual can do more.

It is wrong to assume, as some people seem to, that the industries should keep people at work at times when goods cannot be sold, and should pile up inventory in the mistaken hope that they are thereby maintaining purchasing power and "stabilizing" business. The policy could not succeed, for the industries do not sell only to their own workers, but to all groups of the population. They cannot do business in arbitrary volume, at arbitrary costs and prices, but only in such amounts and on such terms as the needs and the purchasing power of their customers dictate. No manufacturer could operate long in disregard of sales without exhausting his cash assets and leaving himself with huge stocks of goods, at the mercy of a falling market. The attempt would ruin the industries. As these Letters have said before, it is not the factory owners who determine employment; it is the economic system.

Our readers also know that the governing principle in the economic system is the principle of balance. Costs and prices, which represent the terms upon which goods and services are exchanged, must be equitably related if the exchange is to go on, and the distribution of producers among the occupations must be in balance with the demand for their products. When the system is in balance it gives employment to all. A change in any part alters the balance, and requires changes elsewhere. When there is general disturbance trade is blocked and the effect is unemployment and depression; and there is no way of overcoming the blockade without making the changes that will restore the equilibrium.

From this it follows that those who are resisting the necessity for adjustments, and whose lack of understanding and co-operation makes costs and prices inflexible, are holding back recovery. Conversely, those who are resolutely attacking their inventories, and

cutting costs and prices to move goods, are clearing the way for improvement.

The Inventory Situation

The position of inventories in various lines is a question of great interest; also of much verbal speculation, since there are no comprehensive statistics compiled, except those for stocks of agricultural and other materials, which are of varying completeness. The most useful figures, aside from the raw material stocks, are the inventory items in corporation reports, which unfortunately do not appear in great numbers until some time after the date of stock-taking.

From corporate reports thus far available, and from authoritative estimates, we have compiled the following table, showing that inventories of 75 corporations, reporting as of November 30 or December 31, and covering a mixed group of industries, were 14.7 per cent higher than a year earlier. Details for a number of the larger corporations are added:

Inventories of Leading Corporations
(In Thousands of Dollars)

	1936	1937	Per Cent Change
Total 75 Companies	$951,494	$1,091,430	+14.7
General Motors Corp	225,645	290,000†	+28.5
Total 74 Companies, excluding General Motors	725,849	801,430	+10.4
Arlington Mills*	5,572	4,859	—12.8
Atlas Powder Co.	2,886	2,884	— 0.1
A. M. Castle & Co	2,211	2,711	+22.7
Caterpillar Tractor Co	16,670	22,769	+36.6
Chicago Mail Order Co	3,314	2,424	—26.8
Ely & Walker D. G. Co.*	8,663	11,011	+27.1
Endicott Johnson Corp.*	18,272	21,540	+17.9
General Cigar Co.	13,802	12,920	— 6.4
General Tire & Rubber Co.*	4,157	5,728	+37.8
Hibbard, Spencer, Bartlett	3,834	3,328	—13.2
International Shoe Corp.*	28,132	32,652	+16.1
G. R. Kinney Co	3,707	3,520	— 5.0
Lane Bryant, Inc.*	2,879	3,160	+ 9.8
Liggett & Myers Tob. Co.	121,201	133,765	+10.3
Manhattan Shirt Co.*	2,639	3,452	+30.8
McCrory Stores Corp	4,606	4,764	+ 3.4
Mueller Brass Co.*	1,535	2,521	+64.1
Naumkeag Steam Cot. Co.*	2,258	1,736	—23.2
R. J. Reynolds Tobacco Co.	114,855	138,168	+20.3
Rice-Stix Dry Goods Co.*	4,229	4,905	+16.0
Sanford Mills*	4,674	3,325	—28.8
Warner Bros. Pictures*	17,509	20,818	+18.8
Wesson Oil & Snow. Co.*	27,461	22,549	—17.9
Other Companies (51)	310,783	335,921	+ 8.1

*Fiscal year ended Nov. 30. Others Dec. 31.
†Preliminary.

Not enough of these companies publish interim figures to make quarterly comparisons feasible, but the general evidence is that the quarterly peak was reached on September 30. In the manufacturing corporations the reduction from the peak has been small, if any. Compared with the reduced sales, stocks are out of line. The trend is plainly downward but has farther to go, and this will limit the improvement in the primary industries during the next two or three months.

Retail Stocks Sharply Reduced

Inventories of retailers, including mail order houses and chains, have been reduced much more than those of manufacturers. The most encouraging reports of business have come from retail trade. Final figures for December show that department store sales declined less than 2 per cent, in dollars, below 1936. The mail order houses were off approximately the same, and chain stores, taking all lines together, made a slight increase. This is an impressive showing, considering that industrial payrolls and farm income during the month were off 15 and 10 per cent, respectively, according to Government calculations. During January this good record was maintained. New York City department stores were off less than 1 per cent in the first three weeks of the month, and over the country sales appear to have held up well. Merchants have made what price cuts were necessary to move goods, and although the business has been at the expense of profit the general situation has been helped by the sales.

Reports gathered by the Federal Reserve Banks indicate that department store inventories in fully half of the departments had been reduced below a year ago by the end of December. They will be still smaller by the end of January, and commitments are down sharply. Since this is an average, stocks in some lines and stores which are below the average are barely sufficient to operate on.

The large mail order houses have cut stocks drastically from the peak. One of the smaller companies shows a decline of 27 per cent from last year. General Wood of Sears, Roebuck & Co. testified in Washington on January 8 that inventories in distribution industries would be about normal within 30 days.

As distributors' stocks are reduced, clearing of manufacturers' stocks is facilitated, and hereafter will move along more rapidly. Of course there is a possibility that some of the good retail business, stimulated by markdowns, will prove to be at the expense of February and March sales, and that the decline in buying power may have a lagged effect in those months.

Raw Material Stocks Rising

Stocks of raw materials always rise at first when business recedes, since it is in these markets that buying falls most sharply. Producers' stocks of the metals, rubber, wool and rayon yarn have all increased during the past three or four months, and supplies of farm products, especially cotton and feed grains, are large. World rubber stocks at the end of the year were around 585,000 tons, compared with 511,000 at the beginning, and a further increase will occur this quarter. The International Committee has reduced the export quota to 60 per cent for the second quarter, against 70 at

present and 90 in the last half of 1937. The 60 per cent allowance is equivalent to about 215,000 tons, compared with 286,000 in the peak quarter, and should check the rise of stocks.

Wool stocks in the U. S. at the year-end, as reported by the Government, were 270,000,000 pounds, grease weight, against 249,000,000 a year earlier; all the increase is in dealers' and growers' hands, manufacturers' stocks being lower. Rayon yarn manufacturers had 2½ months' supply on hand January 1, and have cut prices and production substantially.

The following table indicates the position of the non-ferrous metals:

Statistical Position of Non-Ferrous Metals in U. S.

First 3 Quarters compared with the 4th Quarter, 1937
(In short tons)

	Copper	Lead	Zinc
Av. Monthly Production:			
Jan. 1-Sept. 30	85,602	43,071	48,456
Oct. 1-Dec. 31	70,405	48,524	51,275
Change	—15,197	+ 5,453	+ 2,819
Av. Monthly Deliveries:			
Jan. 1-Sept. 30	84,182	52,085	51,949
Oct. 1-Dec. 31	35,898	35,721	34,188
Decline	48,284	16,364	17,761
Stocks (Refined)			
On Sept. 30	144,321	90,742	13,517
On Dec. 31	259,908	129,131	64,776
Increase	115,587	38,389	51,259
Prices (Cents per lb.)			
Sept. 28, 1937	14.00c	6.25c	7.25c
Latest	10.00c	4.90c	5.00c

The increase in stocks shown is offset in part by reduction in supplies held by fabricators and consumers, but no figures are available to show this in detail. The totals are of course much smaller than in 1932, or even as recently as the end of 1935, generally speaking. Lead stocks, in fact, are smaller than a year ago. January will bring greater curtailment, and during the month the markets have given evidence that consumers' supplies in some instances need replenishment; but buyers will continue cautious.

Steel stocks in consumers' hands have been substantially reduced. Coal and cement stocks are relatively large. The lumber industry has been prompt in adjusting production to demand, new orders having exceeded output since the end of November. A spokesman for the industry states that it has adjusted its position in seven months from the beginning of the inventory rise, whereas twenty months were required after the 1929 slump.

In general, raw material stocks will remain large until demand improves. Meanwhile producers, in the necessary effort to keep the situation in balance, are losing income, which affects the whole situation. Nevertheless there is no other way. Progress toward recovery requires that individuals and industries get their affairs in order.

Money and Banking

January has brought a heavy seasonal redeposit of currency in the banks. From Christmas week to January 26 money in circulation declined $387,000,000, and, mainly as a result, excess reserves of the member banks rose $430,000,000 to $1,440,000,000, the largest since the increase of reserve requirements on May 1, last. For New York City member banks alone, excess reserves increased approximately $200,000,000 to $515,000,000, or almost as high as they were in April before the last increase of reserve requirements was put into effect. In such comparisons, however, allowance must be made for the higher reserve percentages now in effect which make the potential expansive power of each dollar of "excess" less now than it was then.

Accompanying the growth of excess reserves, balances of interior banks at New York increased over $100,000,000 during January to the highest level since April.

Short-term money rates remained unchanged, save for a temporary easing of the already low rates for Treasury bills.

By the close of January seasonal retirement of currency is normally completed, and usually February brings an upturn; to what extent this can be counted on this year is problematical owing to the decline in employment and general business.

Bank Loans Pared; Investments Up

Loans of the weekly reporting member banks continued to decline and on January 19 were approximately $330,000,000 lower than a month previous. Brokers' and other loans for purpose of purchasing and carrying securities were off $100,000,000 for the month, and something over $650,000,000 since the first of September. Loans for commercial, industrial and agricultural purposes dropped $180,000,000 during the four weeks period, and were down over $400,000,000 since the Fall peak reached in October. The latter reduction, while disappointing in its implications as to general business, suggests progress in liquidating inventories.

With loans decreasing and excess reserves increasing, banks are being forced, for want of earnings, back into investments, the reporting bank figures for the four weeks showing an increase of $134,000,000 in this category—approximately $100,000,000 in "Governments" and the balance in miscellaneous securities. In New York City, the banks were able to offset most of their loan drop by purchases of investments, leaving their total earning assets practically unchanged, but outside of New York the volume of bank credit continued to decline. Possibly, as idle funds in the interior accumulate, banks there may do as New York institutions have done and become more active buyers of Government and other securities.

Reflecting in part the seasonal redeposit of currency, demand deposits adjusted rose moderately in the second two weeks of January after dropping at the beginning of the month to a new low since April, 1936.

Bond Market Mixed

The bond market was featured by pronounced weakness in the railroad group, reflecting general pessimism as to the railroad outlook induced by the Erie receivership and increasingly poor earnings reports. Even highest grade rails were affected to some extent. The following table gives net changes in Moody's averages of corporate bond yields, by classes, for the first twenty-six days of January, and compared with the 1937-38 "highs" and "lows."

Moody's Corporate Bond Yield Averages

	Dec. 31, 1937	Jan. 26, 1938	Change	1937-38 High	1937-38 Low
120 Corporate ...	4.27	4.45	+ .18	4.45	3.64
Aaa	3.21	3.24	+ .03	3.48	3.07
Aa	3.56	3.70	+ .14	3.70	3.27
A	4.29	4.41	+ .12	4.41	3.74
Baa	6.02	6.44	+ .42	6.44	4.46
40 Railroad	5.14	5.74	+ .60	5.74	3.92
Aaa	3.59	3.69	+ .10	3.69	3.29
Aa	4.15	4.60	+ .45	4.60	3.45
A	5.08	5.54	+ .46	5.54	3.92
Baa	7.75	9.12	+1.37	9.12	4.97
40 Public Util.	4.04	4.05	+ .01	4.22	3.66
Aaa	3.09	3.12	+ .03	3.39	3.05
Aa	3.36	3.36	0	3.63	3.29
A	4.02	4.04	+ .02	4.19	3.80
Baa	5.67	5.69	+ .02	5.92	4.47
40 Industrial ...	3.64	3.56	— .08	3.76	3.34
Aaa	2.95	2.92	— .03	3.35	2.81
Aa	3.18	3.14	— .04	3.39	3.05
A	3.77	3.66	— .11	3.89	3.50
Baa	4.64	4.52	— .12	4.98	3.92

As indicated above, the general run of prime to medium corporate bonds outside of the railroad list did fairly well during the month, with some groups even recording slightly lower returns to investors. Practically all classes of speculative bonds, however, were weak.

Responding to the stimulus of easy money and increased commercial bank buying, Government bonds moved substantially higher during the first three weeks, but ran into profit-taking when it became known that both the Federal Reserve Banks and the Treasury had been selling "long" Governments out of portfolio and replacing them with "shorts." These operations, which in the case of the Treasury trust funds involved a special issue of non-market notes, will put the Reserve Banks and the Treasury in a position to switch back into the longer maturities as market conditions warrant.

A good demand for a limited volume of new financing of prime quality appeared in the quick sale of $30,000,000 of Consolidated Edison 3½% debentures and $9,000,000 Consumers Power first mortgage 3½'s, both of which issues rose to a premium, but reacted with the general market to original prices late in the month.

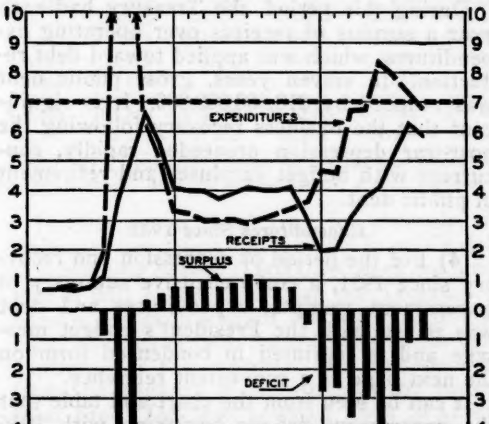
Federal Government Expenditures

In his annual message to Congress last month President Roosevelt made the following statement:

> I have hitherto stated that, in my judgment, the expenditures of the National Government cannot be cut much below $7,000,000,000 a year without destroying essential functions or letting people starve. That sum can be raised and will be cheerfully provided by the American people, if we can increase the nation's income to a point well beyond the present level.

The figure given, $7,000,000,000, is within $500,000,000 of the average annual expenditure during the past five years. It therefore would include the bulk of the special expenditures undertaken in the emergency, and in one form or another would "freeze" them into future budgets.

Expenditures of this size will necessarily require higher tax revenues if the growth of debt is to be checked. Whatever the situation may be in the future, the country has never yet paid in any single year as much as $7,000,000,000 in taxes to the Federal Government. As shown in the accompanying diagram, such a level of expenditures would exceed even the revenue receipts during the war, when the high income and excess profits taxes were applied to inflated corporate and individual incomes.



United States Government Revenue Receipts, Total Expenditures (Excluding Debt Retirement), Annual Surplus or Deficit, and the $7,000,000,000 Level of Future Expenditures Recommended as the Practical Minimum. In Billions of Dollars.

Even if $7,000,000,000 could be collected each year in federal taxes, this would meet only current expenditures and would provide nothing toward a reduction of the gross public debt, which during the past seven years has risen from approximately $16,000,000,000 to over $37,400,000,000.

Four Levels of Government Expenditures

As a background of the present situation, it is pertinent to trace briefly the constant tendency for government expenditures to expand. Since 1900, the expenditures may be grouped into four separate and distinct periods:

(1) From 1901 to 1916, total expenditures were rising gradually, averaged approximately $640,000,000 annually for all purposes, and were balanced by receipts. The normal income tax, introduced in 1913, was 1 per cent and graduated surtaxes began at $20,000 and rose to a maximum of 6 per cent. Today the normal tax is 4 per cent, while surtaxes begin at $4,000 and rise to 75 per cent.

(2) The world war caused an enormous increase in government expenditures, which in the peak year 1919 reached $18,500,000,000 and for the five years 1917-1921 totaled $44,700,000,000. Taxes on corporate and individual incomes were raised to very high rates, but total treasury revenues were far short of the increase in expenditures and public debt was increased from $1,200,000,000 to $26,600,000,000.

(3) Following the war, government expenditures fell back to a fairly even level, which during the period 1922-1930 averaged approximately $3,200,000,000 annually, exclusive of expenditures charged to debt retirement. The pre-war level was never again approached, and the new level of expenditure was 400 per cent higher than the old.

During this period, the Treasury had each year a surplus of receipts over operating expenditures, which was applied toward debt reduction. In eleven years, gross public debt was reduced by $10,600,000,000. It is significant that the business recovery following the post-war depression proceeded rapidly, concurrent with budget surpluses and retirement of public debt.

Expenditures Since 1931

(4) For the period of depression and recovery since 1931, a comprehensive summary of government receipts, expenditures and debt was issued with the President's budget message and is reprinted in condensed form on the next page as a convenient reference.

It can be seen from the chart and table that the government deficits beginning with 1936 reflect, not a shortage of receipts, but the continued heavy expenditures.

On the one side of the ledger, treasury receipts, which had fallen from $4,000,000,000 in 1930 to $2,000,000,000 in 1933, regained the former level by 1936. There was a further sharp gain in 1937 as a result of business recovery, higher tax rates and the imposition of new taxes, including social security taxes. The latest estimate for the 1938 fiscal year, even after three downward revisions, is for total revenues of $6,321,000,000, a new high record for peace times.

On the expenditure side, despite some reduction in regular operating costs between 1930 and 1934, there was an increase in the total, because of financing direct and work relief, and of charging as "expenditures" the subscriptions to stock of the Reconstruction Finance Corporation and the loans made by this and other government agencies to assist railroads, banks, insurance companies, agricultural credit corporations, etc., which were in the nature of recoverable outlays.

Beginning with 1934, although regular operating costs showed only moderate increase, there was a swelling of the total, due principally to the special federal appropriations made to assist different groups—some of which were temporary, such as the bonus to war veterans—and some of which are becoming more or less permanent, such as the AAA benefit payments to farmers, the PWA and CWA work relief program, the Civilian Conservation Corps, public works, loans and grants to municipalities and social security.

Certain of the routine operating items have also been increased materially during recent years, as shown in the table. Approximately $1,000,000,000 per year is now being spent on national defense, a new high record except during war time, and the total may be further increased. Interest on the public debt calls for another $1,000,000,000, even at the low rates carried by government bonds and notes and the almost nominal discount on treasury bills. Interest charges alone are now more than the entire cost of government before the war.

For the six fiscal years, 1934-1939, actual and estimated expenditures, exclusive of debt retirement, aggregate $44,303,000,000, which is equal to the five-year cost of the world war, and averages $7,384,000,000 annually. These expenditures are at the rate of $24,000,000 per day. They are about 130 per cent above the average for the years 1922-1930, and 1,050 per cent above the pre-war average. The nine consecutive deficits since 1931 aggregate $21,556,000,000, exclusive of debt sinking fund.

Trust Funds Now Financing the Deficit

An interesting feature of the budget is the extent to which the investment of social security and other trust funds in the past year has taken over from the open market the burden of financing the deficit. Reserve funds for these pension, unemployment and insurance systems are collected by the Treasury, which invests them in government securities by issuing special treasury notes and certificates. The transactions have the effect of supplying the Treasury with cash and of increasing the public debt, without having to borrow in the open market.

Following are the changes in holdings of government securities by the various trust

United States Government Receipts, Expenditures and Public Debt. Fiscal Years Ended June 30, 1931-39
(In Millions of Dollars)

	Estimated		Actual						
RECEIPTS	1939	1938	1937	1936	1935	1934	1933	1932	1931
Income tax	$ 2,414	$ 2,693	$2,158	$ 1,427	$ 1,099	$ 818	$ 746	$ 1,057	$ 1,860
Miscel. internal revenue	2,190	2,280	2,181	2,010	1,657	1,470	858	504	569
Unjust enrichment tax	10	5	6	—	—	—	—	—	—
Social security taxes	599	571	252	—	—	—	—	—	—
Railroad retirement taxes	117	150	—	—	—	—	—	—	—
Processing tax	—	—	—	77	521	353	—	—	—
Customs	390	415	486	387	343	313	251	328	377
Miscellaneous receipts	199	206	210	216	179	162	224	117	383
Total receipts	$5,914	$ 6,321	$ 5,294	$ 4,116	$ 3,800	$ 3,116	$ 2,080	$ 2,006	$ 3,190
EXPENDITURES									
Regular Operating Expenditures									
Legis., judicial & civil	760	827	815	734	555	475	638	845	710
National defense	991	957	889	870	656	500	634	664	667
Veterans' pensions, etc.	539	574	1,128	2,349	606	554	849	973	943
Interest on the public debt	976	927	866	749	821	757	689	599	612
Other (refunds, etc.)	51	48	48	41	39	63	70	150	97
Total	$ 3,317	$ 3,333	3,746	4,743	2,677	2,349	2,879	3,231	3,028
Public Works	619	878	1,079	912	763	613	459	479	404
Unemployment Relief									
Direct relief	36	127	184	592	1,914	716	351	—	—
Work relief (WPA-CWA)	1,000	1,322	1,897	1,264	11	805	—	—	—
Civilian Cons. Corps	230	310	386	486	436	332	9	—	—
Total	$ 1,266	$ 1,759	2,467	2,342	2,361	1,853	360	—	—
Other Expenditures									
Loans (net)	68	48 *	307*	181*	102	819	912	404	235
Subscriptions to stock	5	46	47	89	157	821	72	627	3
Agric. adjust. program	586	442	516	542	743	290	—	—	—
Social security	813	659	448	28	—	—	—	—	—
Railroad retirement	119	140	5	—	—	—	—	—	—
Supplemental items	75	200	—	—	—	—	—	—	—
Total expend., excluding debt retirement	$ 6,869	$ 7,409	$ 8,001	$ 8,477	$ 6,802	$ 6,745	$ 4,681	$ 4,741	$ 3,671
Debt retirement	202	206	104	403	574	360	462	413	440
Total expenditures	$ 7,071	$ 7,615	$ 8,105	$ 8,880	$ 7,376	$ 7,105	$ 5,143	$ 5,154	$ 4,111
Gross deficit	1,151	1,294	2,811	4,764	3,575	3,989	3,063	3,148	921
Less debt retirement	202	206	104	403	574	360	462	413	440
Net deficit	$ 950	$ 1,088	$ 2,707	$ 4,361	$ 3,002	$ 3,630	$ 2,602	$ 2,735	$ 481
Gross Public Debt.†	38,528	37,604	36,425	33,779	28,701	27,053	22,539	19,487	16,801

Source: Compiled from President's Budget Message of January 5, 1938 and annual reports of the Secretary of the Treasury. * Excess of credits, deduct. † Not including guaranteed debt of government credit agencies.

funds and government credit agencies, and the balance taken, or to be given up, by the open market during the four fiscal years 1936-39:

Changes in U. S. Public Debt Held by Government Agencies and Trust Funds, and Held in the Open Market (by Banks and Trust Companies, Insurance Companies, Corporations, Individuals, etc.)

(In Millions of Dollars)

	Years Ended June 30			
	1936	1937	1938E	1939E
Old-age reserve account	$ —	$ +267	$ +394	$ +482
Railroad retirement account	—	—	+ 80	+ 57
Unemployment trust funds	+19	+293	+658	+573
Government retirement funds	+28	+ 37	+ 56	+ 61
Gov't life insurance funds	+76	+551	—	—
Other trust funds	—26	— 88	— 13	— 10
Postal savings system	+170	+133	—	—
Federal Reserve Banks	—	+ 96	+ 38	—
Other government agencies	+ 42	+ 65	+ 58	—
Sub-total	+ 309	+1,354	+1,266	+1,163
Open market debt	+4,769	+1,292	—87	—239
Total public debt*	$+5,078	$+2,646	$+1,179	$ +924

E—Estimated * Not including guaranteed debt of government credit agencies.

In the current fiscal year, for example, the estimated net deficit and increase in public debt of something over $1,000,000,000 does not mean that it will be necessary for the Treasury to borrow any such amount (exclusive of refundings) through regular loans offered in the open market. On the contrary, the cash received from the issuance of securities to the various trust funds has been counted upon to absorb all of the increase in total debt, and even to permit a small retirement from the open market.

This is in sharp contrast with the changes during 1937 and 1936 when the increases in debt were much larger and were financed to a major extent by the sale of government securities to banks and other investors.

Uncertainty as to the Future

It was emphasized in the President's budget message that the calculated deficits for this year and next assume that actual receipts from

corporate and individual income taxes, old-age benefit taxes and miscellaneous internal revenue will not fall below budget estimates, and that total expenditures, including relief, public works, armament and loans, will not exceed budget estimates.

Obviously, it is difficult to forecast what government receipts may be a year or two years hence, particularly so in view of the recent sharp reversal of the business trend. The Administration frankly recognizes these changes, and in submitting its estimates for 1939 indicates that, for the first time, it will be faced with a decline in revenues instead of an increase.

Moreover, the estimated receipts of social security trust funds by the Treasury, which have been relied upon to finance the deficit and thus make borrowing in the open market unnecessary, are also uncertain, because of the widespread decline in employment during recent months. In the case of the unemployment insurance reserve, which has been expected to bring in $653,000,000 in 1938 and $573,000,000 in 1939, the inauguration of benefit payments to the eligible unemployed in more than twenty States in January, with others to follow soon, may absorb a large portion of current unemployment taxes, and even cause a draft upon the unemployment reserves invested in government securities and held by the Treasury.

Confronted with so many uncertainties, the Administration has chosen the prudent course of trimming expenditures by some $550,000,000 in the budget submitted for the fiscal year 1939. Substantial reduction is recommended in outlays for public building construction, reclamation projects, grants to States and municipalities, flood control, river and harbor improvements and federal aid to highways; and cuts in operating costs of a number of the regular government departments, offices and commissions are provided for. The Treasury Department has not asked that any new taxes be imposed this year, and has expressed its willingness to have existing tax laws amended so as to modify some of the more burdensome provisions.

The continued rise of the public debt, the fact that the budget was not brought into balance in the best year of the recovery, and now the prospect of another deficit, are all the strongest possible reasons why the curtailment of expenses should go much further. Many people who have studied government finances closely believe that a permanent expenditure of around $7,000,000,000 per year by the Federal Government, in addition to the expenditure of perhaps $8,000,000,000 by the state, municipal, county and special district government authorities numbering approximately 175,000, is entirely too high, on the ground that eventually the tax burden will severely depress the standard of living for everybody.

Almost every proposal to curtail government expenditures, however, meets with strong opposition from the representatives of one or more interested groups, and the present efforts of the Administration to hold down spending and to avoid further increases in taxes can prove successful only if they have the active support of business and of the public generally.

Unfortunately, the philosophy has become quite widespread that the special federal grants of millions and billions of dollars in recent years have come out of the "public Treasury" rather than out of the "public's pockets," and that the public therefore has an interest in keeping expenditures at a high level. The fact that federal income taxes are paid by relatively few people, that so many of the federal and other taxes are indirect or "hidden," and that the actual taxes collected in recent years have fallen far short of meeting expenditures, all help to keep this fallacy in circulation.

Housing Since the War

House-building and constructional work of kinds not directly related to war needs were closely restricted during the war, either by regulation or high costs. In the United States, where the population had grown rapidly, this gave a decided check to the industry, and later resulted in abnormal activity in construction.

The rise, climax, and decline of the post-war construction of dwellings are shown by the following table, compiled by the Department of Commerce:

Year	Dwellings built	Year	Dwellings built	Year	Dwellings built
1920......	337,000	1926......	830,000	1932......	97,000
1921......	457,000	1927......	771,000	1933......	60,000
1922......	777,000	1928......	710,000	1934......	60,000
1923......	861,000	1929......	517,000	1935......	133,000
1924......	878,000	1930......	320,000	1936......	275,000
1925......	919,000	1931......	204,000	1937......	300,000*

*Estimated.

Inasmuch as the population of the United States is still increasing, although at a rate much below that of the pre-war years, it is doubtless true that house-building since the war has fallen behind population. However, opinions upon the extent of the building deficit have differed widely, mainly because based upon different theories regarding the problem. President Roosevelt has estimated that 600,000 to 800,000 dwellings should be built annually in order to care for the present growth of population and make good the deficit resulting from the war and since 1929.

As against this estimate, apparently based upon past experience, one widely quoted estimate calls for 14,000,000 new dwellings in the next ten years, of which 3,250,000 should be for replacement of present substandard dwellings,

a like number to offset future obsolescence, 1,000,000 to eliminate "doubling up," and 7,000,000 for the population increase. The makers of this estimate say that it "makes but slight allowance for increasing our standards of space, amenity and convenience, or for any decisive population shift, * * * It does not begin to approach the number of houses that would be required if the American people were housed in the manner to which their natural resources, their labor supply and their technical skill and ingenuity entitle them."

Obviously this estimate looks to a radical change in housing conditions, requiring a large investment of capital, and raising a question as to whether the houses could be sold, or rented, on an economic basis, i.e., on a basis that would yield returns to reproduce the properties or induce continued building.

On the other hand, Mr. Thomas S. Holden, Vice President of the F. W. Dodge Corporation, a well-known authority on building and construction operations, in a recent address emphasized the fact that since 1930 the population has been increasing at the rate of only about 900,000 annually, in comparison with about 1,700,000 in the 1920-30 decade, partly because of new immigration laws, and partly because of a declining birth-rate; also that the rate of increase of urban population in the same period declined 40 per cent. He questioned that anywhere near 14,000,000 new dwellings can be sold or rented in the next ten years, at the present level of costs, even if theoretically "needed," or desirable.

He also said:

> The potential market for dwellings is principally for units to cost, with land, under $5,000, with far the greatest need in the $2,000 to $3,000 range. This potential market represents income classes which have rarely been able to acquire accommodations in new buildings. Consequently, estimated housing needs set at 750,000 units or more a year represent a program that today is socially desirable, but not commercially feasible. Such a program pre-supposes a more rapid abandonment and replacement of unfit housing than we have ever had in this country.

In the past, by common consent, housing has been a private expense, and even in the present emergency the Government has recognized that it cannot go far without the aid of private enterprise and capital. House-building requires a costly investment of labor and materials; and these must be paid for by somebody; if the Government pays, this is but a temporary expedient, for in the end all the Government has must come from the people. Houses will not be built by private enterprise unless they can be sold or rented to pay a return on the costs, and if they are not worth that, it is because the public will pay more for other uses of capital.

There is no fixed and certain demand for new dwellings of an improved type. People build, or rent, as they can afford to, and, also, as they choose to. With prosperity general and employment full, the standard of housing tends to rise, but there is too much value in even an old house for it to be promptly destroyed merely because a better one may be built. Many are built over, but many are used for a long time without much change. Different uses for money are valued by comparison, and there are so many alternative uses in these days that families go on living in old houses when they might have new ones, if they did not prefer to use the money in other ways.

This has more to do with the use of old houses, even in "slums," than is often allowed. According to the Construction Economics Section of the Department of Commerce, demolition of residential buildings between 1920 and 1930 was at the rate of only about 40,000 per year, and most of these occurred in connection with changes in land-use from residential to commercial or other purposes. The testimony of experts is that the only sure way of disposing of "slums" is to buy them and wipe them out. The fact is that a new house, much more than clothing, automobiles, radios, and other "goods" of popular use, represents a "postponable satisfaction," and is frequently postponed in favor of other things. Granted that every family must have a minimum of "house-room," undoubtedly it competes with other wants, and is conceded to be an influence for small families.

Cost a Vital Factor in Housing

All of this leads up to the most important factor in the housing problem, to wit: the cost of a new house in comparison with other things.

Mr. Walter S. Thompson, who is quoted as a student of the subject, has said:

> No one can doubt that a fourth or a third of the present housing units in use would be abandoned tomorrow if their tenants could afford something better, i.e., the rate of obsolescence of the poorer one-third of the housing now in use would be speeded up almost beyond belief if during the next two decades some such lowering of prices, and improvement in the quality of housing should take place as has taken place in automobile construction in the last two decades.
> (Population Growth and Housing Demand, Annals, March 1937, p. 136)

In other words, a house costs too much in comparison with an automobile, and this, probably, is one reason why the average family takes more interest in the latest "model" in one case than in the other; also, it may be that the salesmanship is better.

This not only explains the relatively small demand for new houses, but how much modern industry has done for people of moderate means by reducing the prices of the other things they want. If they could have more of the other things and also better houses, no doubt they would take the latter, but the standard of living is not in houses alone.

Mr. L. J. Chawner, Chief of the Construction Economics Section, Department of Commerce, estimates that

> other things being equal, a 20 per cent reduction in the total purchase price of a house and lot from $4,000 to $3,200 would increase the number of families who

could afford to occupy it by approximately 3,500,000, on the basis of 1929 levels of income. Increasing the number of families whose income, because of reduced prices, enabled them to purchase or rent new dwellings would not only widen the market for residential building but would also give it a stability which it has hitherto lacked.

The last two quotations are from advocates of public housing undertakings on a large scale, but they strikingly show the chief obstacle. The building industry has not kept pace with other industries in modernizaton of methods, and reduction of costs. Yet it is just as true of houses as of automobiles, and everything else, that the way to increase sales is by reducing costs and prices. In early years of the automobile industry, when wages were much lower than now, an automobile cost as much as a very good house, but houses have gone up and automobiles have gone down.

Moreover, this is the history of the industries generally. The iron and steel industry, the electrical industry, and all industries of rapid growth, have built themselves up by reducing costs, lowering prices and enlarging their market. Incidentally, but inevitably, they have increased employment and raised both wages and the standard of living. This has been done by enterprise, invention, scientific research, management, specialized skill, team-work and the use of constantly changing capital equipment to increase the productive powers of labor.

In large constructional work, such as highways, bridges, tunnels, large office buildings, etc., the practices characteristic of manufacturing have been adopted to an important extent, although, even in these, restrictions increase costs; but house-building is largely a "job" industry, instead of being planned for continuous employment and mass production.

Furthermore, house-building is a highly seasonal business, and yearly wages have averaged low, even though hourly wages were seemingly high. The building trades have struggled with this condition, and have thought their only practical policy was that of pushing up wages when work was to be had, although this restricts building. It is agreed that the building trades themselves would be better off, both as wage-earners and as rent-payers, if wages and work-time were together adjusted to produce more yearly pay and more houses; but a lack of cooperation has made the problem baffling. The great war, by creating a scarcity of houses, and at the same time doubling wages, brought on a building crisis.

As bearing upon the above, we quote from a sub-committee of the National Resources Committee, in a recent report to President Roosevelt:

> The provision of domestic shelter has been one of the slowest of the arts to respond to the widespread technical progress of recent times . . . Structurally, the detached houses which were built in the greatest number in 1936 were not essentially different from those built in urban areas one hundred years or more ago . . . The wide technical advance in production methods which has brought the price of adequate clothing, books, a wholesome variety of foodstuffs, even of radios and automobiles in modern times within the range of nearly all persons, finds "modern" houses (not necessarily new ones) beyond the means of one-third to one-half of the families of the United States.

The Annals of the American Academy of Political Science, March 1, 1937, contains a collection of articles from authorities on this subject. A. C. Shire, in an article entitled the "Industrial Organization of Housing," says:

> In an age of large-scale financing, power, and mass production, we have the anachronism that the oldest and one of the largest of our industries, concerned with the production of one of the three essentials of life, is highly resistant to progress, follows practices developed in the days of hand-work, operates as a large number of picayune businesses, is overloaded with a whole series of overheads and profits, is bogged down by waste and inefficiency, is unable to benefit by advancing techniques in other fields, and is tied down to an obsolete system of land utilization.

Another critic says:

> The key to the disabilities of the building industry lies in its lack of integration. In such an industry as steel, a single organization usually controls all phases of production, from the mining of ore and coal to the manufacture of the finished product. In contrast, the building industry is a loose, heterogeneous group of interrelated sub-industries and crafts—large and small contractors, architects, material manufacturers and dealers, carpenters, electricians, bricklayers, painters, real estate companies, mortgage bankers and building and loan associations—each of which has its separate organization and interests.

A survey of the construction industry conducted in connection with the 1930 census has shown that the average volume of residential construction reported for 1929 by 10,881 contractors doing a business of more than $25,000 per year, was about $100,000, and that the total business done by this group was less than one-third that done by the contractors doing less than $25,000 per year. A study by the Bureau of Labor Statistics in 1932, covering about 10,000 building construction establishments, showed an average of eight employes per establishment. These figures show that residential building is a small-scale industry, and incidentally they suggest a pertinent question, viz: If several large corporations should be developed in the building industry, and should reduce the costs of houses as the cost of automobiles has been reduced, will they be condemned because they are big, or encouraged as in the public interest?

Federal Legislation Upon Housing

The general policy of the United States Government in its legislation for the protection of home owners against mortgage foreclosures, and in promoting house building since the depression set in has been that of using its own credit indirectly, through corporations of its own creation, for the guaranty or insurance, of private credit. In this way a margin of public credit has been made to cover the percentage of loss that might occur on a much larger body of private credit.

Under the National Housing Act of 1934, the Federal Housing Administration has insured private loans up to 80 per cent of invested

capital, at a cost to borrowers of 5 per cent interest, plus a ½ per cent service charge and ½ per cent insurance charge. The last two items are to lower costs. These provisions have applied to single, and up to four-family houses, with an insurable limit of $16,000. Approximately $1,000,000,000 has been loaned on these terms.

In his housing message to the extra session of Congress the President proposed to reduce the combined interest and service charge on insured mortgages to 5 per cent, and to make the insurance rate apply to only the diminishing balance of a loan, instead of the original amount. He also proposed to raise the insurable limit of loans of less than $6,000 from 80 to 90 per cent, and to reduce the insurance charge also.

A bill embodying these amendments passed the House but was changed in the Senate by attaching the "prevailing wage" provision, which was eliminated later. As approved by the conference committee, the bill raises the insurable limit on multiple-family houses from $16,000 to $200,000, and to $5,000,000 for limited dividend companies. On the latter class of projects the details are so complex that they cannot be given here.

The Wagner-Steagall Act of 1937 as yet is scarcely in operation. It has established a U. S. Housing Authority in the Interior Department with power to issue $500,000,000 of government-guaranteed securities to finance 60-year loans to housing agencies established by State and local governments. Interest rates may not exceed by more than ½ of 1 per cent the going rate on government borrowings, and operating subsidies or capital grants may be made to provide low rentals. Section 10 reads as follows:

> The Authority may make annual contributions to public housing agencies to assist in achieving and maintaining the low-rent character of their housing projects. The annual contributions for any such project shall be fixed in uniform amounts, and shall be paid in such amounts over a fixed period of years. No part of such annual contributions by the Authority shall be made available for any project unless and until the State, city, county, or other political subdivision in which such project is situated shall contribute, in the form of cash or tax remissions, general or special, or tax exemptions, at least 20% of the annual contributions herein provided.

However, these annual contributions shall not be made from capital funds, or from the proceeds of securities sold to the public, but will be a charge against the regular budget.

In closing his latest message the President made a strong appeal to all factors in industry for cooperation, using very plain language. He said, in part:

> The success of such a program as this, however, cannot be assured by governmental action alone. It will depend mainly on the willingness of industry and labor to cooperate in producing housing at costs that are within the reach of the mass of our people. The goal at which both industry and labor should aim is sustained large-scale production at lower costs to the consumer.
>
> This will mean a larger annual wage for labor because of the larger amount of employment than is possible at high hourly rates with long periods of unemployment. It will mean a larger annual income for industry because of the larger volume of production than is possible at high unit prices with greatly restricted output.
>
> Because this was not the goal of industry and labor during the past construction year, the result soon proved injurious not only to the building industry and its workers, but to business and employment generally. A sharp rise of wage rates and prices in this industry, just before the last building season, reduced by 100,000 to 150,000 the number of new dwelling units that competent authorities had estimated were in prospect for 1937.
>
> It is now clear that we cannot have a strong revival of housing construction on the terms that were exacted by industry and labor last Spring. The rise in hourly wage rates and in material prices was too rapid and too great for the consumer to bear. A similar rise in costs likewise checked production and buying in other industries as well.

Every statement in these four paragraphs is obviously true and fundamentally important, but Section 16 of the Wagner-Steagall Act requires that every contract entered into under it shall contain the "prevailing wage provision" which forbids the very co-operation so pointedly urged by the President. This is inconsistent with the action of Congress in connection with the amendments to the Housing Act now under consideration.

Moreover, the President's argument applies as truly to every important industry as to the building industry. The loss of employment in the last five months has not been confined to building. It has extended into all the industries, and the only adequate explanation is that the rise of industrial costs has been "too rapid and too great for the consumer to bear." The workers of the several industries are consumers of each other's products, and it is true of every group that its products "must be sold at costs that are within reach of the masses of the people." Their interests are inseparable, for no group of the system can buy the products of others except by selling its own.

There need be no unemployment in the United States, or need for the Government to "make" employment, if only the several branches of the productive system will act together to serve their mutual interests. No one of them can serve its own interests by policies that disturb the normal balance between them and lessen the purchasing power of the whole. Unless this community of interests is understood, the system of organized and specialized industry by which the progress of the past has been made would become impossible. What would be the standard of living of a family which had to do everything for itself, without tools, machinery or specialized knowledge? And from the earliest exchange of services down to the latest invention or improvement, the system has been developed upon this principle of co-operation. The highest prosperity of every group can be had only in connection with the highest prosperity of all.

The National City Bank of New York

Head Office · **55 WALL STREET** · *New York*

Seventy-three Branches in Greater New York	**Seventy-one Branches in Twenty-four Foreign Countries**

Condensed Statement of Condition as of December 31, 1937

INCLUDING DOMESTIC AND FOREIGN BRANCHES

ASSETS

Cash and Due from Banks and Bankers	$ 516,778,466.96
United States Government Obligations (Direct or Fully Guaranteed)	482,958,933.69
State and Municipal Bonds	76,494,888.89
Other Bonds and Securities	130,806,876.67
Loans, Discounts and Bankers' Acceptances	609,441,409.92
Customers' Liability Account of Acceptances	13,315,994.07
Stock in Federal Reserve Bank	3,652,500.00
Ownership of International Banking Corporation	8,000,000.00
Bank Premises	50,543,249.33
Other Assets	7,324,112.42
Total	$1,899,316,431.95

LIABILITIES

Deposits		$1,711,552,123.76
Liability as Acceptor, Endorser or Maker on Acceptances and Bills	$48,350,791.66	
Less: Own Acceptances in Portfolio	15,079,116.77	33,271,674.89
Items in Transit with Branches		4,303,780.05
Reserves for:		
Unearned Discount and Other Unearned Income		4,232,502.65
Interest, Taxes, Other Accrued Expenses, etc.		6,792,271.69
Dividend		3,100,000.00
Capital	$77,500,000.00	
Surplus	44,250,000.00	
Undivided Profits	14,314,078.91	136,064,078.91
Total		$1,899,316,431.95

Figures of Foreign Branches are as of December 24, 1937.

$106,855,446.93 of United States Government Obligations and $33,231,693.91 of other assets are deposited to secure $113,186,887.51 of Public and Trust Deposits and for other purposes required by law.

(Member Federal Deposit Insurance Corporation)

City Bank Farmers Trust Company

Head Office · **22 WILLIAM STREET** · *New York*

Condensed Statement of Condition as of December 31, 1937

ASSETS

Cash and Due from Banks	$ 34,183,862.63
United States Government Obligations (Direct or Fully Guaranteed)	31,740,358.81
State and Municipal Bonds	4,443,617.85
Other Bonds and Securities	12,385,160.75
Loans and Advances	10,296,213.96
Stock in Federal Reserve Bank	600,000.00
Bank Premises	4,278,704.25
Other Assets	2,704,611.48
Total	$100,632,529.73

LIABILITIES

Deposits	$ 73,396,509.84
Reserves	3,115,261.28
Capital	10,000,000.00
Surplus	10,000,000.00
Undivided Profits	4,120,758.61
Total	$100,632,529.73

$1,370,000.00 of United States Government Obligations and $136,000.00 of State and Municipal Bonds are deposited with public authorities for purposes required by law.

(Member Federal Deposit Insurance Corporation)

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